

AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL LEGISLATURE AND THE COUNCIL ON INDAKA MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Indaka Municipality, which comprise the statement of financial position as at 30 June 2010, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages 1 to 37.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Local Government Municipal Finance Management Act of South Africa, 2003 (Act No.56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2009 (Act No.12 of 2009) (DoRA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for adverse opinion

Accruals

7. Included in expenditure for the current year is an amount of R650 000 on the preparation and staging of memorial and funeral service of the late mayor. The municipality did not correct this prior period understatement in accruals and expenditure retrospectively in accordance with Standard of Generally Recognised Accounting Practice, GRAP 3, GRAP 3, *Accounting Policies, Changes in Accounting Estimates and Errors*. Consequently expenditure and accumulated surplus for the current year is overstated by R650 000.
8. The municipality did not accrue for invoices in respect of goods and services received amounting to R1,249 million. As a result the accumulated surplus is overstated by R1,249 million and accruals are understated by the same amount in the statement of financial position .

Provisions

9. The valuation, existence, completeness and obligations of the provision for landfill site totalling R75 000 as disclosed in note 13 to the financial statements could not be confirmed due to the limitation placed on the scope of audit work. In this regard no supporting information was produced by the municipality on request and the municipality's records did not permit the application of alternative audit procedures.
10. The municipality had not provided for the leave pay amounting to R164 102. As a result, the leave provision of R954 003 included in the statement of financial position is understated by R164 102 and expenditure is understated by the same amount.
11. The municipality did not disclose prior period errors in accordance with the SA Standards of GRAP, GRAP 3, *Accounting Policies, Changes in Accounting Estimates and Errors* which requires disclosure of the nature and amount of the prior period error for each financial statement line item affected. The nature and amount of the increase in leave provision amounting to R209 619 from the prior year financial statements was not disclosed in the notes to the financial statements and the statement of changes in net assets.

Reserves

12. The municipality disclosed an amount of R2,047 million as an unspent conditional grant liability in note 17 to the financial statements. This amount included in reserves should have been accrued for as a liability in accordance with Standards of Generally Accepted Municipal Accounting Practice, GAMAP 9, *Revenue*. Consequently the reserves is overstated by R2,047 million and the conditional grant liability is understated by the same amount.

Accumulated surplus

13. I was unable to verify the valuation, existence and completeness of the adjustments of R2,019 million to accumulated deficit in the financial statements due to a limitation of scope placed upon my work by the entity. In this regard, no supporting documents and/or explanations were provided for the adjustments made of R 2,019 million, as a result of the transition from the Institute of Municipal Officers (IMFO) basis of accounting to SA Standards of GRAP. The entities records did not permit the application of alternative audit procedures, as no explanations and/or documentation could be provided in support thereof.
14. I did not obtain all the information and explanations I considered necessary to satisfy myself as to the completeness, occurrence and accuracy of the adjustment to the accumulated

surplus of R530 721 included in the statement of changes in net assets. The entity's records did not permit the application of alternative audit procedures, as no explanations and/or documentation could be provided in support thereof.

15. The municipality did not disclose prior period errors in accordance with the SA Standards of GRAP, GRAP 3, *Accounting Policies, Changes in Accounting Estimates and Errors* which requires disclosure of the nature and amount of the prior period error for each financial statement line item affected. The nature and amount of the increase in opening accumulated deficit amounting to R129 453 was not disclosed in the statement of changes in net assets and notes to the financial statements.

Property, plant and equipment

16. I was unable to verify the existence of Furniture and Equipment amounting to R774 600. The entity imposed a limitation on the scope of my work, as these assets did not have unique asset codes, appropriate descriptions and locations recorded on the asset register. The entity's records did not permit the application of alternative audit procedures regarding the existence of these movable tangible capital assets.
17. With reference to accounting policy 3.1, the municipality's accounting policy is to recognise property, plant and equipment at historic cost or at valuation (based on the fair value at date of acquisition), where assets have been acquired by grant or donation while they are in existence and fit for use. However, all fixed assets acquired before 1 July 2007 were stated at re-valued amounts. This is the result of a decision taken by management in that financial year and that caused me to qualify my audit opinion on the financial statements relating to that year. Consequently, property, plant and equipment and accumulated surplus are understated by an amount R1,710 million.

Borrowings

18. As disclosed in note 11 to the financial statements, the corresponding figure for borrowings amounting to R4,652 million was not restated to address a prior year misstatement as required by SA Standards of GRAP, GRAP 3, *Accounting Policies, Changes in Accounting Estimates and Errors*. Consequently borrowings for the prior period are overstated by R219 846 and the accumulated surplus in the statement of financial position is understated by the same amount.
19. The municipality did not disclose prior period errors in accordance with the SA Standards of GRAP, GRAP 3, *Accounting Policies, Changes in Accounting Estimates and Errors* which requires disclosure of the nature and amount of the prior period error for each financial statement line item affected. The nature and amount of the increase in borrowings amounting to R129 302 was not disclosed in the notes to the financial statements and the statement of changes in net assets.

Finance Leases

20. As disclosed in note 12 to the financial statements, the corresponding figure for finance leases amounting to R1,854 million was not restated to address a prior year misstatement as required by SA Standards of GRAP, GRAP 3, *Accounting Policies, Changes in Accounting Estimates and Errors*. Consequently finance lease liability for the prior period is understated by R449 988 and the surplus for the period overstated by the same amount.

Cash and cash equivalents

21. The municipality could not provide sufficient appropriate audit evidence to support the reconciling items totalling R318 685, between cash and cash equivalents stated in the statement of financial position at R4,792 million and the cash at bank amount stated on the year end bank reconciliation at R4,565 million. Furthermore, there was an unexplained difference of R591 800 in the bank reconciliation. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, rights, completeness, and valuation and allocation of cash and cash equivalents.
22. The municipality did not disclose prior period errors in accordance with the SA Standards of GRAP, GRAP 3, *Accounting Policies, Changes in Accounting Estimates and Errors* which requires disclosure of the nature and amount of the prior period error for each financial statement line item affected. The nature and amount of the increase to cash and cash equivalents amounting to R74 441 was not disclosed in the statement of changes in net assets and notes to the financial statements.

Receivables

23. The municipality could not provide sufficient appropriate audit evidence to support a journal entry adjustment of R560 175 to receivables. There was no satisfactory alternative audit procedure that I could perform to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, valuation and allocation of the R560 175 included in receivables.
24. A provision for doubtful debts has not been recognised on long outstanding receivables amounting to R187 991 in accordance with the South African Statement of Generally Accepted Accounting Practice, IAS 39, *Financial Instruments: Recognition and measurement*. Consequently the receivable are overstated by R187 991 and surplus for the year is overstated by the same amount.
25. The municipality did not disclose prior period errors in accordance with the SA Standards of GRAP, GRAP 3, *Accounting Policies, Changes in Accounting Estimates and Errors* which requires disclosure of the nature and amount of the prior period error for each financial statement line item affected. The nature and amount of the decrease in the opening balance for the receivables amounting to R51 378 was not disclosed in the statement of changes in net assets and notes to the financial statements.

Value-added Taxation (VAT) Receivables

26. The municipality did not reconcile the VAT 201 returns submitted to the South African Revenue Services (SARS) throughout the financial year. VAT payable and VAT receivable amounting to R152 599 and R5 912, respectively was not accounted for, VAT refunds amounting to R225 936 were received after year end and no reconciliation was provided for the VAT receivable disclosed as R933 799 in the Statement of Financial Position. Consequently, VAT Receivables is overstated by R707 863 and accumulated surplus is overstated by the same amount.

Expenditure

27. The finance costs of R105 696 included in the statement of financial performance does not agree to finance cost of R383 431 as per the confirmation received from the financial institution. Consequently, finance costs are understated by R277 735 and the surplus for the year is overstated by the same amount.

28. The municipality did not disclose prior period errors in accordance with the SA Standards of GRAP, GRAP 3, *Accounting Policies, Changes in Accounting Estimates and Errors* which requires disclosure of the nature and amount of the prior period error for each financial statement line item affected. The nature and amount of the increase in general expenditure amounting to R383 645 not disclosed in the statement of changes in net assets and notes to the financial statement.

Irregular Expenditure

29. Section 111 and 112 (1) of the MFMA requires the municipality to implement and maintain an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost effective. Payments amounting to R376 014 were made in contravention of the supply chain management requirement. The amount was not included in irregular expenditure, disclosed in note 28.3 to the financial statements, resulting in irregular expenditure being understated by R376 014.

Cash flow statement

30. Presentation of a cash flow statement, summarising the municipality's operating, investing and financing activities is required by SA Standards of GRAP, GRAP 2, *Cash flow statements*. The cash and cash equivalents at 30 June 2010 of R6,294 million, presented in the cash flow statement does not agree to the cash and cash equivalents of R4,792 million. A re-performance of the cash flow statement revealed unexplained differences of R2,451 million.

Basis for adverse opinion

31. In my opinion, because of the significance of the matters described in the Basis for adverse opinion paragraphs, these financial statements do not present fairly the financial position of the Indaka Municipality as at 30 June 2010 and its financial performance and its cash flows for the year then ended, in accordance with the SA Standards of GRAP and in the manner required by the MFMA and DoRA.

Emphasis of matters

32. I draw attention to the matters below. My opinion is not modified in respect of these matters:

Unauthorised expenditure

33. As disclosed in note 28.1 to the financial statement, unauthorised expenditure to the amount of R2,897 million was incurred as a result of overspending on the approved budget.

Irregular expenditure

34. As disclosed in note 28.3 to the financial statements, irregular expenditure to the amount of R105 000 was incurred, as goods were procured without inviting at least three written price quotations.

Additional matter

35. I draw attention to the matter below. My opinion is not modified in respect of this matter:

Unaudited supplementary schedules

36. The supplementary information set out on pages 38 to 44, does not form part of the financial statements and is presented as additional information. I have not audited these

schedules and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

37. As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the following key laws and regulations MFMA, Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) and Municipal Supply Chain Management Regulations (GNR 868 of 30 May 2005) (MSCM Regulations), and financial management (internal control).

Predetermined objectives

38. Material findings on the report on predetermined objectives, as set out on pages 25 to 28 are reported below:

Non-compliance with regulatory and reporting requirements

Existence and functioning of a performance audit committee

39. The performance audit committee did not as required by regulation 4(a) of the Municipal Planning and Performance management regulations:

- review the performance management system and make recommendations in this regard to the municipal council.
- submit a report to the council regarding the performance management system at least twice during the financial year.

Lack of adoption or implementation of a performance management system

40. The municipality did not adopt a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of sections 36, 38 and 41(2) of the MSA, and regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

No mid-year performance assessments

41. The accounting officer did not by 25 January 2010 assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72(1) of the MFMA.

No reporting against predetermined objectives, indicators and targets

42. The municipality did not prepare the annual performance report in terms of section 46 of the MSA, and section 121(3)(c) of the MFMA.

Compliance with laws and regulations

Municipal Finance Management Act, No 56 of 2003

Unauthorised expenditure not disclosed

43. The opening balance of unauthorised expenditure amounting to R360 874 was not reported

to the MEC for Local Government, as required by section 32(4) of the MFMA.

The Audit Committee was not functioning properly

44. The audit committee did not advise the municipal council on matters as stipulated in section 166(2) and (3) of the MFMA.

The Internal Audit Unit was not functioning properly

45. The internal audit did not fulfil its responsibilities as set out in section 165(2) of the MFMA.

Risk assessments not performed

46. Contrary to section 62(1)(c)(i) of the MFMA, risk assessments were not undertaken and a fraud prevention plan had not been developed.

Disposal of capital assets

47. Council approval was not obtained on disposal of capital assets amounting to R102 421 as required by section 14(2) of the MFMA.

Annual financial statements

48. Contrary to section 122(1)(a) of the MFMA, the financial statements were subject to material amendments resulting from the audit.
49. Paragraph 11 et seq. of GRAP 1 Presentation of Financial Statements requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget was not complied as the budget information was not included in the annual financial statements.

Financial management

50. Contrary to section 62(1)(b) of the MFMA and regulation 42 of the MSCM, proper record keeping was not in place resulting in bid documents for a contract awarded to the value of R1,845 million not being available for audit.

Municipal System Act, No 32 of 2000 (MSA)

Supply chain legislative requirements were not adhered to

51. Annual declarations of interest were not made by the mayor and councillors of the municipality as required by section 7(b) of schedule 1 of MSA.

INTERNAL CONTROL

52. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA, MSA, and MSCM Regulations, but not for the purpose of expressing an opinion on the effectiveness of internal control.
53. The matters reported below are limited to the significant deficiencies regarding the basis for adverse opinion paragraph, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

Leadership

54. The accounting officer does not exercise oversight responsibility over financial and

performance reporting, compliance with laws and regulations and internal control. Actions are not taken to address risks relating to the achievement of complete and accurate performance reporting. Furthermore, control weaknesses are not analysed and appropriate follow-up action are not taken that address risks relating to the achievement of performance reporting objectives.

Financial and performance management

55. Systems are not appropriate to facilitate the preparation of quality financial statements and performance reports. The financial statements were subject to material amendments resulting from the audit.

Governance

56. Internal controls were not selected and developed in a manner to prevent, detect and correct material misstatements in financial reporting and reporting on predetermined objectives. Internal audit did not advise the accounting officer on adequacy of internal controls. Moreover, the audit committee did not provide a credible and reliable review of the financial statements.

OTHER REPORTS

Investigations

57. As part of the Provincial Department of Co-operative Governance and Traditional Affairs' intervention in the Indaka Municipality, a forensic investigation was instituted into matters related to procurement and financial controls. The investigation is in progress and should be finalised by 30 November 2010.
58. The municipal manager was suspended during the year pending investigations instituted by the municipal council.

Pietermaritzburg

30 November 2010



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence